

ANALYSIS OF ORIGINAL MEASURE

Franchise Tax Board

Author: Cohn Analyst: Rachel Coco Measure Number: ACA 24
Related Bills: See Legislative History Telephone: 845-4328 Introduced Date: January 4, 2006
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Impose Additional Income Tax Of 1/40th Of One Percent On Income That Exceeds \$1 Million/Domestic Violence Shelter Services Fund

SUMMARY

If approved by the voters, this constitutional amendment would do the following:

- Impose an additional tax at the rate of 1/40th of one percent on the taxable income of a taxpayer subject to tax under the Personal Income Tax law (PITL) that exceeds one million dollars (\$1,000,000).
- Create the Domestic Violence Shelter Services Fund within the State Treasury.

PURPOSE OF THE MEASURE

According to the author's staff, the purpose of this measure is to ensure the future safety of domestic violence victims by guaranteeing a constant funding source for domestic violence service providers.

EFFECTIVE/OPERATIVE DATE

This measure would become effective the day following approval by the voters in the first general election following approval of the measure by the Legislature. The measure specifies an operative date of taxable years beginning on or after January 1, 2006.

POSITION

Pending.

ANALYSIS

STATE LAW

Residents of California are taxed on their entire taxable income (TI), regardless of source, while nonresidents are taxed only on TI from California sources. A part-year California resident's TI for the year they change residency is the sum of the entire TI during the portion of the year they were a resident and the TI from California sources during the portion of the year the taxpayer was a nonresident.

The rate of tax for the 2005 tax year ranges from 1% on TI under \$6,319 for single and separate returns, under \$12,638 for joint returns, and under \$12,644 for head of household returns to a maximum of 9.3% on TI over \$41,476 for single and separate returns, over \$82,952 for joint returns, and over \$56,456 for head of household returns. These tax brackets are indexed for inflation each year.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

S. Stanislaus

3/14/06

Once the tax is calculated, a variety of credits are allowed to reduce the tax. These credits include personal exemption credits, dependent credits, and various incentive credits.

As a result of Proposition 63, beginning with the 2005 taxable year, state tax law imposes an additional 1% tax, not subject to reduction or offset by credits, on the portion of a taxpayer's taxable income that exceeds \$1 million. The estimated revenue from the additional 1% tax is deposited into the Mental Health Services fund on a monthly basis, subject to an annual adjustment.

THIS MEASURE

For taxable years beginning on and after January 1, 2006, this measure would impose an additional tax at the rate of $1/40^{\text{th}}$ of one percent on the amount of a taxpayer's TI, subject to tax under the PITL that is over \$1 million, including estates and trusts estates.

This measure would provide that the additional tax would be subject to the estimated tax payment requirements, interest, penalty, and other tax administration rules, as prescribed with respect to taxes imposed under Revenue and Taxation Code section 17041.

This tax would not be reduced by credits.

This measure would require the revenue, less refunds, derived from the additional tax to be transferred annually to the State Treasurer for deposit into the Domestic Violence Shelter Services Fund, as created by this measure within the State Treasury.

This measure would also establish the Domestic Violence Shelter Services Fund Advisory Council for purposes of allocating the revenue, as specified, to various domestic violence organizations and agencies.

IMPLEMENTATION CONSIDERATIONS

This measure requires that the revenue be transferred on an annual basis to the State Treasurer, but lacks instruction how the amount of the transfer would be calculated. The author may wish to consider the provision enacted as a result of Proposition 63 in which estimates of revenue and a detailed calculation and transfer rate were established.

This measure specifies that all revenues, less refunds, derived from the additional tax shall be transferred annually. Since the normal statute of limitations on filing an amended return resulting in a refund is four years, it is unclear how the department would determine how much revenue to transfer because a portion of the revenue that would be transferred annually could be claimed as refunds in future years.

LEGISLATIVE HISTORY

The Preschool For All Act would impose an additional 1.7% tax on the portion of a taxpayer's income that exceeds specified threshold amounts. The additional revenue would be used to provide funding for preschool programs. This initiative has qualified for the June, 2006, Primary.

Proposition 63, enacted during the November 2, 2004, general election, imposes an additional tax of 1% of the amount of a taxpayer's taxable income that is over \$1 million and precludes any reduction in this tax by any otherwise allowable credits.

OTHER STATES' INFORMATION

The states surveyed include *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, *New Jersey*, and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Illinois, *Massachusetts*, and *Michigan* impose a flat tax of 3%, 5.3%, and 3.9%, respectively. *Minnesota* has a progressive rate with a maximum tax rate of 7.85%. These rates apply to the 2005 taxable year.

For taxable years 2003 through 2005, *New York* added two additional tax rates, which increased the maximum rate from 6.85% to 7.5% and 7.7%. For taxable years beginning after 2005, the rates revert back to a maximum of 6.85%.

Starting with the 2004 tax year, New Jersey imposes an additional tax of 2.6% on taxpayers earning more than \$500,000. The additional tax increases the top tax rate from 6.37% to 8.97%. The revenue generated by the additional tax will be used to support property tax relief for the states lower income taxpayers and senior citizens.

FISCAL IMPACT

Costs to administer this measure will be determined once the department's implementation concerns have been resolved.

ECONOMIC IMPACT

Revenue Estimate

This bill measure would result in the following revenue gains:

Estimated Revenue Impact Of ACA 24 (Cohn) (\$ Millions)			
Fiscal Year	2005/2006	2006/2007	2007/2008
Revenue Gain	+\$10	+\$26	+\$28

Any possible changes in employment, personal income, or gross state product that might result from this measure are not taken into account.

Revenue Discussion

The above estimates are based on the department's personal income tax model. It is estimated that this measure would impact approximately 66,000 taxpayers. For purposes of this estimate, and in the same manner as the mental health services tax, the \$1,000,000 threshold was the same for individual, joint and head-of-household filers.

ARGUMENTS/POLICY CONCERNS

Funding based on additional taxes imposed on high income taxpayers creates uncertainty since the amount of income reported by high income taxpayers is volatile.

Should this additional tax be enacted it could be increased, repealed, or changed only by one of the three methods as prescribed by Article XVIII of the California Constitution.

LEGISLATIVE STAFF CONTACT

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